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IN THE

Supreme Court of the United States

October Term, 1974

No. 74-

BETHLEHEM STEEL CORPORATION,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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Petitioner, Bethlehem Steel Corporation ("Bethlehem"), respectfully prays that a Writ of Certiorari issue to review the judgment of the United States Court of Claims entered in this action on February 19, 1975. The action involves a Wunderlich Act appeal from decisions of the Armed Services Board of Contract Appeals.

Opinions Below

The opinion of the Court of Claims, dated February 19, 1975 (*"Bethlehem II"*), is reported at 511 F.2d 529 (1975) and is reproduced at App. 133*. The decisions and opin-

* References to "App." are to pages of the concurrently-filed separate Appendix. The Table of Contents to the Appendix lists the page of the Appendix at which each separate opinion or order set forth therein begins.

ions of the Armed Services Board of Contract Appeals ("ASBCA") affirmed by the judgment of the Court of Claims are reported at 71-1 BCA ¶ 8640 and 73-1 BCA ¶ 9898 and are at App. 21 and App. 42, respectively. An earlier opinion of the Court of Claims in this case, dated March 20, 1970, ("*Bethlehem I*") and reported at 423 F.2d 300 (1970), is at App. 1 and an unreported Order of the Court of Claims, dated July 1, 1971, is at App. 41.

Jurisdiction

The judgment of the Court of Claims was entered on February 19, 1975 (App. 133). Bethlehem's timely motion for rehearing and reconsideration was denied on March 28, 1975 (App. 161). This Court has jurisdiction to issue the prayed-for Writ under 28 U.S.C. § 1255(1).

Question Presented

Whether the Department of Defense, acting through an administrative committee not authorized by contract or regulation to hear or determine contract disputes, upon the *ex parte* application of a military department then in disputes clause litigation with a private contractor, has the power to require the Armed Services Board of Contract Appeals to apply, *ad hoc* and retroactively, rules-of-decision in that litigation favorable to the military department.

Constitutional Provision, Statute and Regulations Involved

The decision below determined an appeal of decisions of the ASBCA to the United States Court of Claims pursuant to the Wunderlich Act, 41 U.S.C. §§ 321-322. The decision below raises issues under the Fifth Amendment and concerns the application of certain provisions of the Armed Services Procurement Regulations, 32 C.F.R.

§§ 3-808. The text of the Fifth Amendment, the Wunderlich Act and the relevant portions of the Armed Services Procurement Regulations are set forth at the end of this petition.

Statement of the Case

This case presents important questions concerning the fair and impartial administration of contract disputes procedures as to two contracts (NObs-3556 and NObs-3648) between Bethlehem and the Navy for the construction of five destroyers.

The Contracts

The contracts are two of seven contracts awarded by the Navy between December 15, 1952, and January 27, 1956, to four shipbuilding contractors* for the construction of a total of eighteen DD931-type destroyers. (App. 51) The facts concerning the award of the contracts and Bethlehem's performance are not in issue and are set forth in detail in the opinion of the ASBCA at App. 42.

Each of those contracts contained a provision which required the contractor to exclude from its proposed price any provision for anticipated inflation in labor and material costs which could be expected to occur during the life of the contract. In consideration for the reduced contract price resulting from such exclusion, the Government contracted to reimburse the contractor, according to an agreed formula, for such increases in labor and material costs. Such contract price "escalation" was to be an automatic adjustment, subject only to Article 6(e) of the contracts, which provided:

> "(e) The Contracting Officer may deny, in whole or in part, any upward adjustment in the contract price required under this Article if the Contracting Officer finds that such adjustment is not required, in

* Bath Iron Works, Bethlehem Steel Corporation, Ingalls Shipbuilding and Puget Sound Bridge and Dredging Co.

whole or in part, to enable the Contractor to earn a fair and reasonable profit under this contract."

The construction and delivery of the destroyers pursuant to these contracts was completed by 1959. Bethlehem completed its deliveries to the Navy pursuant to its contracts in a timely manner, delivering the last destroyer in February 1958. There is no dispute that the destroyers delivered by Bethlehem were of "very good quality." (App. 103)

As anticipated by the parties, Bethlehem and other contractors in the DD931 program suffered significant inflationary increases in costs of labor and material. As a consequence, they submitted claims for escalation in contract prices. In January 1960 Bethlehem submitted to the Contracting Officer a claim for escalation in the contract price to cover its inflationary increases in labor and material costs. The amount of Bethlehem's claim, determined pursuant to the escalation formula in the contract, was $3,347,500 on NObs-3556 and $2,404,900 on NObs-3648. With the full escalation sought by Bethlehem, contract profit margins would have been 9.3 percent (NObs-3556) and 9.6 percent (NObs-3648).

In August 1964, four years later, the Contracting Officer refused any reimbursement whatsoever of Bethlehem's cost increases on the grounds that no escalation in contract price was required "to enable the Contractor to earn a fair and reasonable profit" within the meaning of Article 6(e) of the contracts. As matters then stood, Bethlehem would have obtained a profit on the two contracts of 3 percent (NObs-3556) and 2.3 percent (NObs-3648). In at least three out of the other five contracts, other shipbuilding contractors constructing DD931-class destroyers received escalation sufficient to recover profits of 15.2 percent, 15.32 percent and 10.1 percent. (App. 63)

Regulations Applicable to Determining "Fair and Reasonable Profit"

At the time the contract was awarded, there were no published guidelines in the Armed Services Procurement Regulations ("ASPR") as to how procurement officials were to determine what constituted a "fair and reasonable profit".*

In July, 1957, published guidelines for determining the fairness and reasonableness of profit levels were adopted by the Department of Defense. Those guidelines consisted of a number of factors which procurement officials were directed to "consider" in evaluating the proper level of profit in a Government contract. 22 F.R. 5930 (July 26, 1957). However, there was no direction or guide to Contracting Officers as to how they were to arrive at an appropriate dollar or percent-of-cost profit once they had "considered" those factors. Accordingly, the 1957 guidelines (amended in 1960) have generally been referred to as the "unweighted" guidelines.**

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* However, as the Court of Claims stated in *Bethlehem I* (App. 9):

> ". . . . Since Government officials are presumed to act properly, it is reasonable to suppose that the Pentagon would not have promulgated clauses such as Article 6(e) unless contracting officers could employ established techniques and guidelines, even if unpublished, and therefore would not act arbitrarily."

** Those were the guidelines in effect at the time of the ASBCA decision which was subsequently reviewed by the Court of Claims, in *Newport News Shipbuilding and Dry Dock Co.* v. *United States*, 374 F.2d 516 (Ct. Cl. 1967) ("*Newport News*"). *Newport News* involved a shipbuilding contract for the aircraft carrier USS Ranger which contained an escalation clause identical to that in Bethlehem's contract. The ASBCA in its initial decision in *Newport News* in 1962 had failed to apply the unweighted guidelines. The Court of Claims held, 374 F.2d at 530, the "failure to apply [profit] guidelines prescribed by authority in a regulation [to] be an error of law". Although at the time of the Court of Claims decision in *Newport News* in 1966, the unweighted guidelines at issue had been superseded by the weighted guidelines, the Court noted that their discussion "of course relates to the guidelines as they were [when the ASBCA rendered its opinion]". *Id.*

By the time of the Contracting Officer's decision in this case (August, 1964), the unweighted regulations had been superseded by more detailed, remedial guidelines. Adopted in August 1963 for immediate use, these regulations directed procurement officials to weigh the factors previously applicable according to certain standards set forth in detail in the regulations. 28 F.R. 12546, amending 32 C.F.R. Part 3, § 3-808; see "Notes and Filing Instructions" quoted at App. 156. These "weighted" guidelines were designed "to reduce the impact of subjective factors in the mind of the administering official[s]". (*Bethlehem I* App. 17; see also App. 8-9, 157) The Assistant Secretary of Defense recommended the adoption of the weighted guidelines to the Secretary of Defense as a "quantifying of existing policy" intended to force contracting officers "to give discriminating and analytical attention" to the weighting of the previous unweighted factors.* *Id.*

Decisions Below

ASBCA

The ASBCA, in August 1966, ruled that Bethlehem was restricted to a five percent profit under each of its contracts as "fair and reasonable". (App. 7) The ASBCA fixed on five percent on the theory that that was the profit to which the parties had agreed in the negotiation of the contracts. The ASBCA did not apply or advert to the weighted guidelines, then in effect and published in 32 C.F.R. ¶ 3-808, or to the superseded unweighted guidelines.

*The memorandum reflecting that recommendation was quoted in the *Appeal of Newport News Shipbuilding and Dry Dock Co.*, dated February 9, 1971, 71-1 BCA ¶ 8705. The ASBCA stated in that appeal that the "weighted" guidelines were an implementation of historical Government profit objectives, stating:

> "The ultimate policy objectives of the Department of Defense with respect to profit, while not explicitly made public in the 1960 guidelines, were subsequently disclosed in 1963 in terms which leave no doubt that they had been present all along." (71-1 BCA ¶ 8705, at 40,455)

Bethlehem I

Bethlehem brought this action in the Court below asserting as an error of law the ASBCA's failure to apply the weighted guidelines in effect in 1966 at the time of the ASBCA's decision. The Court, following the rationale of *Newport News,* agreed with Bethlehem:

> ". . . . Plaintiff [Bethlehem] desires to take its chances under the 'weighted guidelines method' and it has a legal right to do so." *Bethlehem I,* App. 1, 17.

The Court saw "no injustice or anomaly in applying profit limitation techniques, as the Pentagon may have amended and prescribed them from time to time, up to the date of the determination" (App. 17), and stated:

> ". . . . The involved regulations, however, when made, appeared to be remedial, meant to safeguard defense contractors against determinations as to a reasonable profit level, arbitrary, perhaps biased, or founded on 'seat-of-the-pants intuition', which contracting officers might take without proper guidelines. There is no reason to postulate an intent to withhold such safeguards from parties to then existing contracts, nothing to that effect appearing either in the contracts or the regulation." (App. 8-9)

The Navy did not argue that the weighted guidelines should not be applied to contracts entered into prior to their effective date, nor did it argue that the unweighted guidelines should apply to Bethlehem's contract.

Rather, the Navy argued that this case was an "exception" and fell "clean outside all published guidelines" because Bethlehem had not been the low bidder on NObs-3556 and NObs-3648. (App. 10-11) The Court rejected that argument, noting:

> "If defendant's postulated exemption exists, it must be a large one. The record shows that all of

plaintiff's above named competitors in the shipbuilding industry were awarded major contracts at one time or another between World War II and 1954, when they were not the low bidders, for reasons the same as those which animated the award of NObs-3556 to plaintiff. The situation recurs so commonly in our litigation with other industries heavily dependent on defense work, that we may take judicial notice of it: a rigid adherence to procurement from the lowest bidder only is viewed in the Pentagon as gradually freezing out the competition and leading into single-source procurement." (App. 12)

Upon examination of the weighted guidelines, the Court held that the "exception" sought by the Navy was nowhere mentioned.

". . . . To put it succinctly, the alleged exception has every earmark of having originated in the active mind of defense counsel herein, not in the perhaps more rigid thinking of the Pentagon." (App. 12)

The Navy also argued that the weighted guidelines were not applicable because (i) the parties in the negotiation of the contract had agreed that a 5 percent profit was "fair and reasonable" and (ii) the "weighted" guidelines method would produce a higher, unintended result and thus be "so unfair that an exception to the method must be implied". (App. 13) The Court rejected that argument:

". . . . The contracts, however, reflect that plaintiff [Bethlehem] agreed only upon a price . . . ." (App. 13)

For the second time, the Court directed strong language at the lack of any factual or record basis for the Navy's arguments:

". . . The alleged agreement to a 5% level, in a contract that viewed prospectively could have resulted in anything from a loss to a windfall profit level,

according to its terms, must be regarded as located in defendant's counsel's eyes alone." (App. 14)

Having adjudicated Bethlehem's "legal right" to the application of the weighted guidelines, the Court went on to say:

"If we have erred in thinking the 'Weighted guidelines method' is feasible to apply to the instant contracts, the Pentagon even now could amend or supplement its regulation, and the Board would be bound, provided no impairment of vested rights was attempted. Any amendment purporting to reaffirm the position now claimed, that officials determining a reasonable level of profit under clauses such as Article 6(e) are not subject to any published guidelines whatever in certain cases, at least would advisedly be made in light of the recent statement of the Supreme Court: '* * * a broad, roving authority, a type of administrative absolutism [is] not congenial to our law-making traditions.' *Gutknecht* v. *United States*, 396 U.S. 295, 90 S.Ct. 506, 24 L.Ed.2d 532." (App. 17-18)

ASPR Committee

Seizing upon the Court's reference to the possibility that the Pentagon might further "amend or supplement" its regulation, attorneys for the Navy sought and obtained *ex parte** a declaration by an administrative committee in

* The *ex parte* proceedings were commenced by a memorandum originating in the Office of the General Counsel of the Navy. That memorandum stated that it had been prompted by the Court of Claims decision in *Bethlehem I* and that the instructions of the ASPR Committee sought by the Navy would be presented to the ASBCA for use in contract disputes procedures with respect to Bethlehem's contract. It is clear that Navy attorneys initiated the *ex parte* proceedings and drafted the instructions (styled "Minutes") of the ASPR Committee; the Court below so found. *Bethlehem II*, App. 140. Indeed, the memorandum referred to above bears the initials of Morris Amchan, the Navy attorney immediately responsible for the conduct of the contract disputes proceedings for the Navy before the ASBCA. Bethlehem has stated in its papers in the Court below, without contravention by the Navy, that Mr. Amchan wrote the *ex parte* application and drafted the ASPR Committee "Minutes".

the Pentagon called the Armed Services Procurement Regulation Committee (the "ASPR Committee") that the weighted guidelines were not applicable to these contracts because such application would result in an increase in the profits of the contractor beyond that "considered by the parties in the negotiation of the contract to be fair and reasonable". Navy attorneys did not advise the ASPR Committee that they had made precisely that argument to the Court of Claims in *Bethlehem I* and that the Court of Claims had rejected it as having been "located in defendant's counsel's eyes alone". (App. 14) Although Navy attorneys submitted to the ASPR Committee selected excerpts from the Court of Claims decision in *Bethlehem I,* they did not provide the Committee with a complete copy of the decision.

"Minutes" of the ASPR Committee meeting embodying its decision were drafted by Navy attorneys, were presented to the Committee and were adopted substantially verbatim.* Those "Minutes" stated that the "weighted"

*The ASPR Committee is made up of two persons appointed by the Assistant Secretary of Defense (Installations and Logistics) and two persons (one a procurement policy representative and one a legal representative) appointed by each of the military departments and by the Defense Supply Agency. The Committee's primary function is to act in an advisory capacity to the above-named Assistant Secretary on matters pertaining to the Armed Services Procurement Regulations. DoD Instruction 5126.3, December 20, 1961 (1 CCH Government Contracts Reporter ¶ 825).

The ASPR Committee has been delegated no authority to participate in contract disputes appeal procedures, either under DoD Regulations or pursuant to the disputes clause. The Secretary of Defense and the Secretaries of each of the military departments have designated the ASBCA as the only "authorized representative" to hear appeals in contract disputes proceedings (¶ 1, Armed Services Board of Contract Appeals, Part 1—Charter (4 CCH Government Contracts Reporter, ASPR A Part 1, ¶ 35, 551)) and the contract disputes clause only authorizes disputed questions to be determined by such "authorized representative". DoD Instruction 5126.3, *supra.,* establishing the ASPR Committee, does not prescribe any rules of procedure and does not by its terms provide for notice to be given to affected parties of its proceedings, for affected parties to be given an opportunity to be heard or for proceedings not to be conducted *ex parte.*

guidelines" effected a substantive change in the standards existing at the time the contracts were entered into and were intended for the development of a profit objective for negotiation of future contracts". (As the dissent below pointed out, ". . . there is no evidence in the record to support the ASPR committee's statement that only prospective application was intended" (App. 155); there is nothing in the majority opinion to the contrary.)

The "Minutes" of the ASPR Committee directed a "deviation", *i.e.,* a non-standard procurement procedure, with respect to this contract clause, and instructed the ASBCA that the superseded unweighted guidelines should be applied in determining what level of profits was "fair and reasonable" under Article 6(e) of Bethlehem's contract.

Bethlehem was not given notice of the pendency of these collateral proceedings or opportunity to be heard.

ASBCA

The ASBCA believed itself to be "bound" by the ASPR Committee action (App. 38) and, as a result, did not pass on such questions (raised by Bethlehem) as the authority of ASPR under its charter to decide this issue absent approval of higher Department of Defense officials (App. 33) or the absence of any factual basis for the assertions of the Navy attorneys and thus for the committee's action (App. 33).*

Applying the unweighted guidelines, the ASBCA determined that Bethlehem was entitled to full escalation on NObs-3648 (resulting in a 9.6 percent profit) but restricted Bethlehem's escalation on NObs-3556 to a 6.3 percent profit level. (App. 130-131). Believing itself aggrieved on NObs-3556 by the failure of the ASBCA to apply the

* Bethlehem immediately appealed the ASBCA decision to the Court of Claims asking that Court to clarify and reaffirm its earlier opinion adjudicating Bethlehem's "legal right" to the application of the weighted guidelines. The Court of Claims declined to review the decision at that time. (App. 41)

appropriate weighted guidelines, Bethlehem sought further review as to that contract in the Court of Claims.

Bethlehem II

In *Bethlehem II* (App. 133), the Court of Claims in a sharply-divided opinion,* approved the retroactive application of the ASPR Committee "Minutes" in Bethlehem's contract disputes proceedings. As with the ASBCA, the majority below did not go behind the Navy's assertions to review the basis for the ASPR Committee instructions.

The Court held two factors as "favoring retroactive application" of the ASPR Committee "decision": first, the "long lapse of time" between the original contract award and final disposition; second, the remedial effect of applying "a guideline regulation, any regulation" as opposed to interpreting the contract without reference to any guidelines. (App. 137-8)

The Court condemned as "not . . . entirely cricket", as "deplor[able]", and as "outrageous" the *ex parte* conduct of Navy attorneys but refused to provide Bethlehem with a remedy in order not "to prolong this already inordinately prolonged litigation, to the advantage of no one knows whom".** (App. 142-3)

The dissent below pointed out that consistent with *Bethlehem I* the only question open to the Court was whether application of the weighted guidelines was "feasible", in the sense of either "possible" or "reasonable" or "suitable".

*The Court of Claims was divided four-to-three, Judge Nichols writing the majority opinion for Judges Davis, Skelton and Kashiwa, with Judge Bennett writing a strong dissent, in which Judges Durfee and Kunzig concurred.

**It is clear to whose "advantage" the abrupt and arbitrary halt in this litigation has accrued—the Navy. Condoned in the interests of expediency are *ex parte* methods, agreed by all seven judges below to have been "outrageous", which are an anathema to notions of fundamental fair play and procedural due process. In its desire to stop this lawsuit, the majority has permitted the Navy attorneys and the ASPR Committee to engage in precisely that "administrative absolutism" verbally condemned, but effectively condoned, by the Court.

(App. 153) The dissent noted, first, that there "can be no dispute" that it was possible to apply the weighted guidelines (App. 153)—the Navy had done so and had clearly not liked the results. Second, the application of the weighted guidelines would not be "unreasonable" when "used appropriately" to take account of the fact that Bethlehem was not the lowest bidder. (App. 153-4). Finally, the dissent dealt with each of the Navy's arguments that application of the weighted guidelines was "unsuitable", dismissing each as lacking support in the record and as having been previously rejected in *Bethlehem I*. (App. 154-7)

Reasons for Granting the Writ

The judgment sought to be reviewed holds that the Department of Defense, acting through the Armed Services Procurement Regulation Committee, upon *ex parte* application of a military department then in disputes clause litigation and without notice to the private contractor involved, has the power to require the ASBCA to apply, *ad hoc* and retroactively, rules-of-decision in that litigation favorable to the military department. In so holding, the judgment (i) is inconsistent with decisions of this Court which impose contractual and constitutional requirements of procedural regularity and basic fair play on the Government in its dealings with private parties and (ii) poses important questions and raises substantial problems in the impartial administration of disputes clause appeals before the ASBCA.

Argument

The power of the ASPR Committee, under the decision below, is "a broad, roving authority, a type of administrative absolutism not congenial to our law-making traditions". *Gutknecht* v. *United States*, 396 U.S. 295, 306 (1970). The power was invoked by the Navy here, not to

facilitate ongoing procurement of goods or services, but to depress the recovery of moneys earned by Bethlehem under a contract which had been fully performed twelve years earlier.

Similar to the power of the Selective Service under its delinquency regulations, at issue in *Gutknecht*, such power has no statutory standard or even guidelines. The power of the ASPR Committee is exercised entirely at its own discretion — stimulated no doubt by the *ex parte* approaches of the military departments with pending contract disputes.

The decision below resolves the question presented here in a manner which is fundamentally inconsistent with decisions of this Court which are designed to protect private contractors in litigation with the Government from the retroactive application of unilateral, litigation-oriented changes in Government regulations.

1. The Government Must Conform to its Own Regulations and, During the Pendency of Litigation, May Not Apply, Ad Hoc and Retroactively, More Onerous Administrative Rules Designed To Improve Its Litigating Posture.

This Court has held in a number of decisions through the years that due process requires that the Government conform to its established regulations and procedures and not deviate therefrom on an *ad hoc* basis when it believes its interests so dictate. *Greene* v. *United States*, 376 U.S. 149 (1964); *Vitarelli* v. *Seaton*, 359 U.S. 535 (1959); *Service* v. *Dulles*, 354 U.S. 363 (1957); *United States ex rel. Accardi* v. *Shaughnessy*, 347 U.S. 260 (1954); *see also United States* v. *Heffner*, 420 F.2d 809, 811-13 (4th Cir. 1970); *Berends* v. *Butz*, 357 F.Supp. 143, 151 (D. Minn. 1973).

The Department of Defense has failed in this case to conform to its own regulations in two different ways. In the first place, the Department of Defense, acting through the ASPR Committee, has deviated on an *ad hoc* basis in a pending contract disputes litigation from its published

weighted guidelines method of evaluating the fairness and reasonableness of profit levels in negotiated contracts. In the second place, the Department of Defense, by acting through the ASPR Committee in determining the issue of what guidelines are applicable in making determinations under Article 6(e) of Bethlehem's contract, has failed to conform to its own regulations designating the ASBCA as the "authorized representative" in hearing and determining appeals in contract disputes cases "as fully and as finally" as might the Secretaries of Defense and of the military departments.

The *Greene* case is instructive on the first point. In that case Greene's employment was terminated in 1953 based on the administrative revocation of his security clearance by the Department of the Navy. Following this Court's determination that Greene's security clearance revocation had been improper, Greene sought to recover compensation for the Government's unauthorized action based on a regulation adopted in 1955. In 1960, while Greene's claim was pending, the Department of Defense "amended" its 1955 regulation so as to subject Greene's recovery to administrative discretion and to other impediments not present in the 1955 regulation. This Court held that Greene could not be forced to proceed under the amended, 1960 regulation, citing *Union Pac. Ry.* v. *Laramie Stock Yards Co.*, 231 U.S. 190, 199 (1913), to the effect that:

> ". . . 'a retrospective operation will not be given to a statute which interferes with antecedent rights . . . unless such be the "unequivocal and inflexible import of the terms, and the manifest intention of the legislature" ' ".

The *Accardi* case is instructive on the second point. There the Attorney General had included Accardi on a confidential list of "unsavory characters" whom he wished to deport, prior to the decision of a Board of Immigration Appeals

on Accardi's application for suspension of deportation proceedings. Applicable regulations then in effect delegated to the Board of Immigration Appeals such discretionary authority "as is appropriate and necessary for the disposition of the case". 8 C.F.R., 1949, § 90.3(c), cited at *United States ex rel. Accardi* v. *Shaughnessy, supra.,* 347 U.S. at 266. Accardi sought to block his deportation and offered to prove that the Board of Immigration Appeals' later denial of Accardi's application was the result of the Attorney General's instructions, but the District Court refused to accept Accardi's offer of proof. This Court reversed, holding that had the decision of the Board of Immigration Appeals resulted from the Attorney General's instruction, it would have been in error:

> "In short, as long as the regulations remain operative, the Attorney General denies himself the right to side-step the Board or dictate its decision in any manner". *United States ex rel. Accardi* v. *Shaughnessy, supra.,* 347 U.S. at 267.

This Court then noted:

> "It is important to emphasize that we are not here reviewing and reversing the *manner* in which discretion was exercised. If such were the case we would be discussing the evidence in the record supporting or undermining the alien's claim to discretionary relief. Rather we object to the Board's alleged *failure to exercise* its own discretion, contrary to existing valid regulations." *Id.,* at 268 (Emphasis in original.)

See also, S & E Contractors, Inc. v. *United States,* 406 U.S. 1 (1972); *United States* v. *Anthony Grace & Sons, Inc.,* 384 U.S. 424 (1966).

The decision below is inconsistent with both *Greene* and *Accardi.* Under the decisions of the Court of Claims in *Newport News* and *Bethlehem I,* Bethlehem was entitled to

the application by the ASBCA of published DoD profit guidelines in effect at the time of ASBCA's decision in 1966, *i.e.,* the weighted guidelines. Immediately after *Bethlehem I,* and prompted by that decision, the Department of Defense, through the ASPR Committee issued an administrative instruction, considered binding by the ASBCA, that the subjective and superseded unweighted guidelines which had been discarded nine years earlier by the Department of Defense would be applied in this case in lieu of the more objective and remedial weighted guidelines. That administrative decision, issued by the ASPR Committee, was a "deviation" from published regulations of the Department of Defense, favorable to the military department—the Navy—in this litigation. And that administrative decision, on an issue in a disputes appeal pending before the ASBCA, was rendered by a committee not authorized by Department of Defense regulations to determine disputed questions in contract disputes appeals.

The change in the rules-of-decision was not effected by statute or by a general change in the overall administrative scheme. Here, the change in the rules-of-decision was a "deviation" from standard procurement practices prompted by, and intended to effect the outcome of, pending litigation. The "deviation" itself was not a more precise explication of ambiguous terminology; the "deviation" was not the extension of the regulatory scheme to areas of application not anticipated when the regulation was adopted. The "deviation" was the *ad hoc* repeal of an entire body of remedial guidelines in favor of subjective superseded guidelines.

Unlike *Accardi* there is no question that the administrative "deviation" was made to effect the outcome of this litigation. The Navy stated that it had been prompted to start the *ex parte* proceedings by the Court of Claims decision in *Bethlehem I;* the Navy claimed that the Court of Claims had invited the ASPR Committee to determine the applicability of the weighted guidelines to Bethlehem's contracts;

the Navy asserted that a higher profit would result from application of the weighted rather than unweighted guidelines; the Navy asked that the ASPR Committee instructions apply to the contract clause whose applicability was at issue only in this litigation with Bethlehem; and the Navy stated explicitly that it intended to present the ASPR Committee instructions to the ASBCA panel hearing Bethlehem's appeal.

It is clear that the Navy sought to do what it did because it believed that it had a better chance at depressing Bethlehem's recovery under the discretionary and unpredictable unweighted guidelines than it did under the objective and predictable weighted guidelines. Although application of the unweighted guidelines consistent with historical DoD profit policies should have produced the same result as application of the weighted guidelines, see *supra.* at 6n*, as indeed it did in *Newport News,* 71-1 BCA ¶ 8705 and with respect to Contract NObs-3648 below, App. 129-30, the greater subjectivity in the application of the unweighted guidelines gave the Navy the leverage of greater administrative discretion than if the weighted guidelines were applied. The Navy was successful in its strategy to the extent of $1,595,009 as to the contract still at issue in this case. Bethlehem submits that the Government cannot be permitted to manipulate published guidelines in such a manner as to achieve an improved litigating posture.

And Bethlehem submits further that protection from such arbitrary manipulation by administrative officials is precisely the objective that the weighted guidelines were designed to achieve and precisely this Court's objective in such cases as *United States ex rel Accardi* v. *Shaughnessy, supra.,* and *Greene* v. *United States, supra.* The Government simply cannot be permitted to manipulate "the law" in ways that serve its interest and quash the rights of contractors.

2. The Department of Defense May Not Finally Determine Issues in Litigation Before the ASBCA Upon Ex Parte Application of a Military Department and Without Affording the Contractor an Opportunity to Be Heard.

The "deviation" from standard procedure mandated by the ASPR Committee was obtained through an *ex parte* application of the attorneys for the Navy in this litigation. The decision of the ASPR Committee was taken by the ASBCA as "binding", not advisory. As a consequence, the Navy has not yet been forced to prove its assertions concerning the merits of the guideline substitution in an adversary hearing in which Bethlehem has had notice and an opportunity to be heard and to present its evidence.

With respect to the decision of the ASPR Committee, the Court of Claims held that such an *ex parte* approach was not improper because the ASPR Committee was a "rule-making" body to whom *ex parte* procedures were "normal". App. 144

In the context of this case, that holding is fundamentally at odds with this Court's repeated condemnations of *ex parte* procedures as inconsistent with "underlying concepts of procedural regularity and basic fair play". *Gonzales* v. *United States,* 348 U.S. 407, 412 (1955); *see also Willner* v. *Committee on Character and Fitness,* 373 U.S. 96 (1963); *Morgan* v. *United States,* 304 U.S. 1 (1938).

The "deviation" sought and obtained by Navy attorneys in the ASPR Committee proceedings was not a "rule-making" in any sense of that word. The ASPR Committee decision did not involve any particular expertise or legislative or political judgment. The ASPR Committee had to draw on no particular management or procurement background or sources in deciding that question. There was no complex "business" decision required. There was no "amendment" to existing regulations, in the sense of a clarifying, simplying or elaborating construct on existing regulations in-

tended to be widely applied. The "deviation" from standard procedures was not the product of dissatisfaction with the existing regulations arising out of experience with the weighted guidelines.

The proposal submitted to the ASPR Committee by the Navy requested a determination that the weighted guidelines not be applied retroactively to Bethlehem's contract because the effect of application "would be to increase the profit of the contractor beyond that considered by the parties in the negotiation of the contract, to be fair and reasonable." That question is the kind of question regularly and routinely adjudicated by quasi-judicial bodies or by courts themselves. And the "deviation" that was adopted by the ASPR Committee was no more than a decision of the question of whether the requested guidelines would be applied retroactively in this case. Indeed, the ASPR Committee determined one of the precise issues which was then pending before the ASBCA.

Under these circumstances the *ex parte* action of the ASPR Committee would appear to be wholly improper and the ASPR Committee action a nullity. But if any effect be ascribed to that action, the ASBCA must be given the opportunity to redetermine the issue independently, i.e., completely *de novo*. Here, the ASBCA felt itself "bound" by the ASPR Committee action and consequently did not itself inquire into the adequacy of the basis for the ASPR Committee action.

Bethlehem was entitled to participate, to offer evidence and to be heard *on the merits* of its position before the decision to change the guidelines had been administratively determined. That right derives in the first instance from its contract with the Navy wherein it is agreed that:

> "In connection with any appeal proceeding under this Article, the Contractor shall be afforded an opportunity to be heard and to offer evidence in support of its final appeal." (Article 33. DISPUTES.)

Bethlehem contracted for the right to be heard and to offer evidence in support of its appeals with respect to all disputed questions of fact and incidental questions of law heard before the ASBCA, *S & E Contractors, Inc.* v. *United States, supra.*, 406 U.S. at 9 n. 6; Armed Services Board of Contract Appeals, Part 1—Charter ¶ 5 (4 CCH Government Contract Reporter ¶ 35,551) ("When an appeal is taken pursuant to a disputes clause in a contract which limits appeals to disputes concerning questions of fact, the Board may nevertheless in its discretion hear, consider, and decide all questions of law necessary for the complete adjudication of the issue."), and Bethlehem was entitled to have the benefit of the administrative procedures it had bargained for. *United States* v. *Anthony Grace & Sons, Inc., supra.*, 384 U.S. at 429.

The question of what is a "fair and reasonable profit" under Article 6(e) is a disputed fact, and the issue of what guidelines are applicable in determining that disputed fact is a question involving both fact and law, but in any event a matter coming within the jurisdiction of the ASBCA.

This implies, at the very least, that Bethlehem was entitled "to be heard and to offer evidence" in an ASBCA proceeding in which the Navy was required to prove *de novo* its assertions that the "weighted" guidelines were not intended to be applied to existing contracts.

Bethlehem was entitled to a hearing as well because of the strictures of the Due Process Clause of the Fifth Amendment. Bethlehem has, in effect, been deprived of an important contractual right without essential due process requirements of notice and opportunity to be heard. See *Lynch* v. *United States,* 292 U.S. 571, 579 (1934).

("Valid contracts are property, whether the obligor be a private individual, a municipality, a State or the United States. Rights against the United States arising out of a contract with it are protected by the Fifth Amendment.")

Thus, where the Navy, in litigation with a private contractor, initiates and participates in ASPR Committee proceedings in order to obtain *ad hoc* instructions binding on the ASBCA on the particular legal and factual questions then pending before the ASBCA, the contractor must be given notice of those proceedings and an opportunity to respond to the Navy's contentions and, if any effect be given to such ASPR Committee action in later ASBCA proceedings, the issues resolved by the ASPR Committee must be redetermined *de novo* by the ASBCA.

The end result of the chain of procedural horrors discussed above is that Bethlehem has had what the Court in *Bethlehem I* characterized as a "legal right" dissolved without any administrative or judicial body deciding the merits of its side of the story.

The practice approved below is not a one-time injustice. The ASPR Committee is a continuing body whose military department members have an on-going interest in the outcome of contract disputes before the ASBCA. There is no reason to suppose the ASPR Committee and its military department members will voluntarily renounce the broad, roving authority granted by the Court below to the ASPR Committee to issue "deviations" from standard procurement procedures in pending contract disputes proceedings.

In order to preserve the orderly and impartial administration of contract disputes under the quasi-judicial structure fostered by this Court, the decision below must be reversed.

Conclusion

For the reasons stated above, petitioner Bethlehem Steel Corporation prays that a Writ of Certiorari issue to the United States Court of Claims to review its decision of February 19, 1975.

Respectfully submitted,

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Constitutional Provision, Statute and Regulations Involved

1. The Fifth Amendment to the Constitution provides:

> "No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation." (U. S. Const. Amend. V)

2. The Act of May 11, 1954, 68 Stat. 81 (The Wunderlich Act), 41 U.S.C. §§321-322, provides:

> "§321. *Limitation on pleading contract-provisions relating to finality; standards of review*
>
> "No provision of any contract entered into by the United States, relating to the finality or conclusiveness of any decision of the head of any department or agency or his duly authorized representative or board in a dispute involving a question arising under such contract, shall be pleaded in any suit now filed or to be filed as limiting judicial review of any such decision to cases where fraud by such official or his said representative or board is alleged: *Provided, however,* That any such decision shall be final and conclusive unless the same is fradulent [sic] or capricious or arbitrary or so grossly erroneous as necessarily to imply bad faith, or is not supported by substantial evidence.

"§322. *Contract-provisions making decisions final on questions of law*

"No Government contract shall contain a provision making final on a question of law the decision of any administrative official, representative, or board."

3. Relevant provisions of the Armed Services Procurement Regulations, Title 32 (Cum. Supp. as of January 1, 1960) (the "unweighted" guidelines) provide:

"§3.808-1 *General.*

"A fair and reasonable provision for profit or fee cannot be made by simply applying a certain predetermined percentage to the cost estimate or selling price of a product. Rather, the profit or fee should be first established as a dollar amount, after considering the factors set forth in this section. Therefore, where a fee is involved and it is necessary to determine the percentage relationship between the fee and the estimated cost of the contract in order to comply with administrative and statutory limitations on fees for cost-reimbursement type contracts, the percentage shall be determined only after the dollar amount of the fee has been established for negotiation purposes. [Amdt. 49, 24 F.R. 10631, Dec. 24, 1959]

"§3.808-2 *Factors for Determining Fee or Profit.*

"The factors set forth in subparagraphs (a) through (i) below should be considered in determining profit or fee in all contracts, whether for supplies or services; for construction work; or for experimental, developmental, or research work; and whether of the fixed-price type or of the cost-reimbursement type unless otherwise specified in the particular factor. All of the following factors, as set

forth in paragraphs (a) through (i) of this section should be evaluated in the light of the basic policy set forth in §3.801-1 which provides that supplies and services shall be procured from responsible sources at fair and reasonable prices calculated to result in the lowest overall cost to the Government:

(a) *Effect of Competition.* Where competition is adequate and effective and proposals are on a firm fixed-price basis, the contracting officer normally need not consider in detail the amount of estimated profit included in a price. Where effective competition is lacking, the estimate for profit for the proposed fixed fee should be analyzed in the same manner as all other elements of price, applying the factors set forth in this section.

(b) *Degree of Risk.* (1) The degree of risk assumed by the contractor should influence the amount of profit or fee a contractor is entitled to anticipate. For example, where a portion of the risk has been shifted to the Government through cost-reimbursement or price redetermination provisions, unusual contingency provisions, or other risk-reducing measures, the amount of profit or fee should be less than where the contractor assumes all risk.

(2) Some cost-plus-a-fixed-fee contracts and task orders for research and development call for the delivery of prototypes of other "hardware." Other such contracts or task orders require only that the contractor exert its "best efforts" to deliver the required end item. Frequently this is because the contractor is not willing to assume

the additional burden of incuring substantial cost overruns without additional fee in order to complete performance. When the contract calls for delivery of developed models in accordance with well-defined performance or design characteristics or a predetermined delivery schedule, or both, in contrast to an obligation only to exert its "best efforts" to develop and deliver such models, payment of the fee should be conditioned on performance in accordance with the contractor's obligation to deliver, and in such cases the contractor may be entitled to a larger fee both because of the risk inherent in its commitment and because of the successful completion of the work.

(c) *Nature of Work to Be Performed.* A major consideration in the determination of the amount of profit or fee, particularly in connection with experimental, developmental, or research work, is the difficulty or complexity of the work to be performed and any unusual demands of the contract, such as whether the project involves a new approach unrelated to existing equipment or only refinements on existing equipment, whether the caliber or class of engineer involved is that of an "idea-man," or whether the contractor is to be required by the contract to assign to the work unusually skilled talent.

(d) *Extent of Government Assistance.* The Department of Defense encourages its contractors to perform their contracts with the minimum of financial, facilities, or other assistance from the Government. Where extraordinary financial, facilities, or other assistance must be furnished to a contractor by the Government,

such extraordinary assistance should have a modifying effect in determining what constitutes a fair and reasonable profit or fee. (See also §3.404-3(d).)

(e) *Extent of the Contractor's Investment.* The extent of a contractor's total investment (i.e., both equity and borrowed capital) in the performance of the contract will be taken into consideration in determining the amount of the fee or profit.

(f) *Character of Contractor's Business.* Recognition must be given to the type of business normally carried on by the contractor, the complexity of manufacturing techniques, the rate of capital turnover, and the effect to each individual procurement upon such business. For example, where a contractor is engaged in an industry where the turnover of working capital is low, generally the profit objective on individual contracts is higher than in those industries where the turnover is more rapid.

(g) *Contractor's Performance.* In addition to the factors set forth in §3.101, the contractor's past and present performance should be evaluated in such areas as quality of product, quality control, scrap and spoilage, efficiency in cost control (including need for and reasonableness of cost incurred), meeting delivery schedules, timely compliance with contractual provisions, creative ability in product development giving consideration to commercial potential of product), engineering (including inventive, design simplification, and development contributions), management of subcontract programs,

and any unusual services furnished by the contractor. Where a contractor has consistently achieved excellent results in the foregoing areas in comparison with other contractors in similar circumstances, such performance merits a proportionately greater opportunity for profit or fee. Conversely, a poor record in this regard should be reflected in determining what constitutes a fair and reasonable profit or fee.

(h) *Subcontracting.* In negotiating the profit or fee, the nature and extent of any subcontracting should be considered, particularly as it bears on the contractor's performance, administrative responsibility, financial investment, and degree of risk as outlined above. The degree and nature of subcontract programs vary on a broad spectrum. While it is not possible to define precisely the exact profit or fee treatment to be accorded each situation, the general guidelines which follow will be taken into consideration. The evaluation of a contractor's subcontracting program should not consist merely of applying arbitrary percentages of profit to subcontract prices in negotiating the prime contract price. A relatively large amount of subcontracting need not make for negotiation of a lesser profit or fee—the character and circumstances of the subcontracting and the effect on the prime contractor's costs must be taken into account. Although purchased material and subcontracted work are usually properly included in the base upon which profit is computed, instances may arise in which a significant portion or portions of a contract are subcontracted in such a way that only a minimum

amount of responsibility or risk remains with the prime contractor. In such a case, the amount of fee or profit should be less than where the contractor assumes substantial risk. Of primary importance is the degree to which the subcontracting provides a better product and lower costs, with timely delivery, and in which the contractor assumes heavy managerial effort, responsibility and risk. In this connection, consideration should be given to the contractor's past and present effectiveness in offering to qualified small business concerns and to firms in labor surplus areas an opportunity to compete for subcontracts (see for example §1.707-3) and to the contractor's furnishing assistance to such concerns as they require or as the Government may specifically request. A contractor's effectiveness in furnishing such opportunity or assistance to an unusual or exceptional degree, should be given favorable consideration in determining the amount of fee or profit.

(i) *Unrealistic Estimates.* If records reveal that a contractor's actual costs are consistently lower than his estimated costs (indicating a practice of excessive estimates), and if the contractor refuses to provide what seems to be reasonable estimate of costs, a lower profit or fee should be considered." [Amdt. 49, 24 F.R. 10632, Dec. 24, 1959]

* * *

4. Relevant portions of the Armed Services Procurement Regulations, Title 32 (Cum. Supp. as of January 1, 1966) (the "weighted" guidelines) provide:

"§3.808 *Profit, including fees under cost-reimbursement type contracts.*

[28 F.R. 12555, Nov. 23, 1963]

"§3.808-1 *Policy.*

"(a) *General.* It is the policy of the Department of Defense to utilize profit to stimulate efficient contract performance. Profit generally is the basic motive of business enterprise. The Government and defense contractors should be concerned with harnessing this motive to work for more effective and economical contract performance. Negotiation of very low profits, the use of historical averages, or the automatic application of a predetermined percentage to the total estimated cost of a product, does not provide the motivation to accomplish such performance. Furthermore, low average profit rates on defense contracts overall are detrimental to the public interest. Effective national defense in a free enterprise economy requires that the best industrial capabilities be attracted to defense contracts. These capabilities will be driven away from the defense market if defense contracts are characterized by low profit opportunities. Consequently, negotiations aimed merely at reducing prices by reducing profits, with no realization of the function of profit cannot be condoned. For each contract in which profit is negotiated as a separate element of the contract price, the aim of negotiation should be to employ the profit motive so as to impel effective contract performance by which overall costs are economically controlled. To this end, the profit objective must be fitted to the circumstances of the particular procurement, giving due weight to each of the performance, risk, and other factors set forth in §§3.808-3.808-6. This will result in a wider range of profits which in many cases, will be significantly higher than previous norms.

(b) *Contracts priced on the basis of cost analysis.* When cost analysis is performed pursuant to §3.807-2, profit considerations shall be in accordance with the objectives set forth below. As an inducement for broad reduction in defense costs, the Government should establish a profit objective for contract negotiations which will:

(1) Reward the contractor who undertakes more difficult work requiring higher skills;

(2) Allow the contractor an opportunity to earn profits commensurate with the extent of the cost risk he is willing to assume—the greater the risk assumption, the greater the profit objective established;

(3) Reward those contractors who have an excellent record of past performance and conversely penalize those contractors whose performance has been poor; and

(4) Reward contractors who provide their own facilities and financing or who have established their competence through prior development work undertaken at their own risk.

The weighted guidelines method set forth in §3.808-2 for establishing profit objectives is designed to provide reasonably precise guidance in applying these principles. This method, properly applied, will tailor profits to the circumstances of each contract in such a way that long range cost reduction objectives will be fostered, and a wider spread of profits will be achieved.

(c) *Contracts priced without cost analysis.* On many contracts and subcontracts, good pricing does

not require an examination into costs and profits. Where adequate price competition exists and in other situations where cost analysis is not required (see §3.807), fixed-price type contracts will be awarded to the lowest responsible offerors without regard to the amount of their profits. Under these circumstances, the profit which is anticipated, or in fact earned, should not be of concern to the Government. In such cases, if a low offeror earns a large profit, it should be considered the normal reward of efficiency in a competitive system and efforts should not be made to reduce such profits.

[30 F.R. 5981, Apr. 29, 1965]

"§3.808-2 *Weighted guidelines method.*

"(a) *General.* (1) The weighted guidelines method provides contracting officers with (i) a technique that will insure consideration of the relative value of the appropriate profit factors described in §3.808-4 in the establishment of a profit objective and the conduct of negotiations; and (ii) a basis for documentation of this objective, including an explanation of any significant departure from this objective in reaching a final agreement. The contracting officer's analysis of these profit factors is based on information available to him prior to negotiations. Such information is furnished in proposals, audit data, performance reports, pre-award surveys and the like. No more data on or analysis of costs should be required in the establishment of a profit objective than is required to determine if costs are reasonable. The weighted guidelines method shall be used in all contracts where cost analysis is performed except as set forth in paragraph (b) of this section.

(2) The contractor's proposal will include cost information for evaluation and a total profit figure. Contractors shall not be required to submit the details of their profit objectives but they shall not be prohibited from doing so if they desire. Elaborate and voluminous presentations are neither required nor desired and may indicate a low index of cost effectiveness, which fact itself should be taken into consideration by the contracting officer in the appropriate section of the weighted guidelines.

(3) The negotiation process does not contemplate or require agreement on either estimated cost elements or profit elements, although the details of analysis and evaluation may be discussed in the fact-finding phase of the negotiation. If the difference between the contractor's profit objective and the contracting officer's profit objective is relatively small, no discussion of individual factors may be necessary. If the negotiating parties' objectives are relatively far apart, a disclosure of weightings and rationale by both parties may be made concerning the total assigned to Input to Total Performance, Assumption of Cost Risk, Performance, Selected Factors and Special Profit Consideration. By thus developing a mutual understanding of the logic of the respective positions, an orderly progression to final agreement should result. Simultaneous, not sequential, agreement will be reached on cost, any incentive profit-sharing formulas, or limitation on profits, and price. The profit objective is a part of an overall negotiation objective which, as a going-in objective, bears a distinct relationship to the target cost objective and any proposed sharing arrangement. Since the profit is merely one of several inter-

related variables, the Government negotiator shall not complete the profit negotiation without simultaneously agreeing on the other variables. Specific agreement on the exact weights or values of the individual factors is not required and should not be attempted.

(b) *Exceptions.* (1) Under the following circumstances, other methods for establishing profit objectives may be used. Generally, it is expected that such methods will accomplish the two features of the weighted guidelines methods set forth in paragraph (a)(1) of this section. These circumstances are:

(i) Architect-engineering contracts;

(ii) Personal or professional service contracts;

(iii) Management contracts, e.g., for maintenance or operation of Government facilities;

(iv) Contracts with non-profit organizations where fees are involved;

(v) Termination settlements;

(vi) Engineering services, labor-hour, time-and-material, and overhaul contracts providing for payment on a man-hour, man-day or man-month basis, and where the contribution by the contractor constitutes the furnishing of personnel rather than the output of an integrated research, engineering, or manufacturing organization; and

(vii) Cost-reimbursement construction contracts.

(2) Other exceptions may be made in the negotiation of contracts presenting unusual pricing situations when specifically authorized by the head of a procuring activity. Such exceptions shall be justified in writing and authorized only in situations where the weighted guidelines method is determined to be unsuitable.

(c) *Limitation.* In the event this or any other method would result in establishing a fee objective in violation of limitations established by statute or this subchapter, the maximum fee objective shall be the percentage allowed pursuant to such limitations. (See §3.405.) No local administrative ceilings on profit shall be permitted.

[30 F.R. 5981, Apr. 29, 1965]

"§3.808-3 *Profit objective.*

"(a) A profit objective is that part of the estimated contract price objective or value which, in the judgment of the contracting officer, is appropriate for the procurement being considered, covering the profit or fee element of the price objective. This objective should realistically reflect the total overall task to be performed and the requirements placed on the contractor. Prior to the negotiation of a contract, change order, or contract modification, where cost analysis is undertaken, the negotiator shall develop a profit objective. The weighted guidelines method, if applicable, shall be used for developing this profit objective. If a change or modification is of a relatively small dollar amount and is basically the same type of work as required in the basic contract, the application of the weighted guidelines method will generally result in a profit objective

similar to the profit objective in the basic contract, and therefore this basic rate may be applied to the contract change or modification. However, in cases where the change or modification calls for substantially different work, then the basic contract profit and the contractor's input to total performance may be radically changed and a detailed analysis is necessary. Also, if the dollar amount of the change or contract modification is very significant in comparison to the contract dollar amount, a detailed analysis should be made.

(b) Development of a profit objective should not begin until after a thorough (1) review of proposed contract work; (2) review of all available knowledge regarding the contractor, pursuant to Subpart I, Part 1 of this chapter, including performance, capability reports, audit data, pre-award survey reports and financial statements, as appropriate; and (3) analysis of the contractor's cost estimate and comparison with the Government's estimate or projection of cost.

[30 F.R. 5982, Apr. 29, 1965]

"§3.808-4 *Profit factors.*

"(a) The factors set forth below shall be considered in all cases in which profit is to be specifically negotiated. The weight ranges listed after each factor shall be used in all instances where the weighted guidelines method is used.

Profit factors	*Weight ranges (percent)*
Contractor's input to total performance—	
Direct materials:	
Purchased parts	1 to 4
Subcontracted items	1 to 5
Other materials	1 to 4
Engineering labor	9 to 15
Engineering overhead	6 to 9
Manufacturing labor	5 to 9
Manufacturing overhead	4 to 7
General and administrative expenses	6 to 8
Contractor's assumption of contract cost risk	0 to 7
Type of contract.	
Reasonableness of cost estimate.	
Difficulty of contract task.	
Record of contractor's performance	−2 to +2
Management.	
Cost Efficiency.	
Reliability of cost estimates.	
Cost reduction program accomplishments.	
Value engineering accomplishments.	
Timely deliveries.	
Quality of product.	
Inventive and developmental contributions.	
Small business and labor surplus area participation.	
Selected factors	−2 to +2
Source of resources.	
Government or contractor source of financial and material resources.	
Special achievement.	
Other.	

(b) Under the weighted guidelines method, the contracting officer shall first measure the "Contractor's Input to Total Performance" by the assignment of a profit percentage within the designated weight ranges to each element of contract cost recognized by the contracting officer. Such costs are multiplied by the specific percentages, which have been selected in accordance with §3.808-5(b), to arrive at specific dollar profits.

(c) The suggested categories under the Contractor's Input to Total Performance are similar to those on the Cost and Price Analysis Form (DD Form 633). Often, individual proposals will be in a different format; but, since these categories are broad and basic, they provide sufficient guidance to evaluate all other items of cost.

(d) Although certain classifications of acceptable cost, including travel, subsistence, facilities, test equipment, special tooling, federal manufacturers excise taxes, and royalty expenses, may have been historically excluded from the base upon which profit has been computed, they shall not be excluded when using the weighted guidelines method.

(e) After the contracting officer has computed a total dollar profit for the Contractor's Input to Total Performance, he shall divide this amount by the total recognized costs to determine the composite profit percentage for this factor. To this composite percentage, he shall then add the specific percentages assigned for cost risk, performance, and the other selected factors, to arrive at a total profit percentage. He shall then multiply the total recognized contract costs by this total profit percentage to determine the profit objective. A cardinal principle of the weighted

guidelines method is that the specific percentages assigned for cost risk, performance, and other factors are applied to total recognized costs in establishing the profit objective.

[30 F.R. 5982, Apr. 29, 1965]

"§3.808-5 *Assignment of values to specific factors.*

"(a) *General.* In making his judgment of the value of each factor, the contracting officer should be governed by the definition, description, and purpose of the factors together with considerations for evaluating them as set forth herein.

(b) *Contractor's input to total performance.* This factor is a measure of how much the contractor himself is expected to contribute to the overall effort necessary to meet the contract performance requirements in an efficient manner. This factor, which is apart from the contractor's responsibility for contract performance, takes into account what resources are necessary and what the contractor himself must do to accomplish a conversion of ideas and materials into the final product called for in the contract. This is a recognition that within a given performance output, or within a given sales dollar figure, necessary efforts on the part of individual contractors can vary widely in both value and quantity, and that the profit objective should reflect the extent and nature of the contractor's contribution to total performance. The evaluation of this factor requires an analysis of the cost content of the proposed contract as follows:

(1) *Direct materials (purchased parts, subcontracted items and other material).*

* * *

(2) *Engineering labor and manufacturing labor.*

* * *

(3) *Engineering overhead, manufacturing overhead, and general and administrative expenses.*

* * *

(c) *Contractor's assumption of contract cost risk.* (1) This factor reflects the policy of the Department of Defense to shift the risk of contract costs to the fullest extent practicable to contractors and to compensate them for the assumption of this risk. Evaluation of this risk requires a determination of (i) the degree of cost responsibility the contractor assumes, (ii) the reliability of the cost estimates in relation to the task assumed, and (iii) the chances of the contractor's success or failure. This factor is specifically limited to the risk of contract costs. Thus, such risks on the part of the contractor as reputation, losing a commercial market, risk of losing potential profits in other fields, or any risk on the part of the purchasing activity, such as the risk of not acquiring an effective weapon, are not within the scope of this factor.

(2) The first and basic determination of the degree of cost responsibility assumed by the contractor is related to the sharing of total risk of contract cost by the Government and the contractor through the selection of contract type. The extremes are a cost-plus-fixed-fee contract requiring only that the contractor use his best efforts to perform a task, and a firm fixed-price contract for a complex item. Such cost-plus-fixed-fee contract would reflect a minimum assumption of cost responsibility, whereas such firm fixed-price contract would reflect a complete assumption of cost responsibility. Therefore, in the first step of determining what value is to be

given for the contractor's assumption of contract cost risk, a zero rating shall be given to a proposed cost-plus-fixed-fee best efforts contract, and a 7-percent rating shall be given to a closely priced firm fixed-price contract for a new, complex item.

(3) The second determination is that of the reliability of the cost estimates. Sound price negotiation requires well-defined contract objectives and reliable cost estimates. Prior production experience assists the contractor in preparing reliable cost estimates on new procurements for similar equipment and does not in any way reduce his cost responsibility in a firm fixed-price contract. An excessive cost estimate reduces the possibility that the cost of performance will exceed the contract price, thereby reducing the contractor's assumption of contract cost risk.

(4) The third determination is that of the difficulty of the contractor's task. The contractor's task can be difficult or easy, regardless of the type of contract.

(5) Contractors are likely to assume greater cost risks only if contracting officers objectively analyze the risk incident to proposed contracts and are willing to compensate contractors for it. Generally, a cost-plus-fixed-fee contract would not justify a reward for risk in excess of 1 percent, nor would a firm fixed-price contract justify a reward of less than 5 percent. Where proper contract type selection has been made the reward for risk by contract type would usually fall into the following percentage ranges:

Type of contract	*Percentage ranges*
Cost-plus-fixed-fee	0 to 1
Cost-plus-incentive-fee including cost incentive only	1 to 2
Cost-plus-incentive-fee including cost, performance, and delivery incentives	1½ to 3
Fixed-price-incentive including cost incentive only	2 to 4
Fixed-price-incentive including cost, performance, and delivery incentives	3 to 5
Prospective price redetermination	4 to 5
Firm fixed-price	5 to 7

* * *

(d) *Record of contract performance.* (1) The purpose of this factor is to motivate contractors to improve their performance by rewarding them for excellent past performance and penalizing them for poor performance. Effective use of this factor requires that (i) reports on the various aspects of past performance be obtained and evaluated; and (ii) this information be used in such a way as to motivate contractors to improve their performance.

* * *

(6) The following factors are to be considered in evaluating a contractor's performance record:

(i) *Management.*

* * *

(ii) *Cost efficiency.*

* * *

(iii) *Reliability of cost estimates.*

* * *

(iv) *Cost reduction program accomplishments.*

* * *

(v) *Value engineering accomplishments.*

* * *

(vi) *Timely deliveries.*

* * *

(vii) *Quality of product.*

* * *

(viii) *Inventive and developmental contributions.*

* * *

(ix) *Small Business and Labor Surplus Area Participation.*

* * *

(e) *Selected factors.* The purpose of these factors, which may enter into a particular procurement situation, is to discourage reliance upon Government resources, and to encourage contractors to outstanding performance. Therefore, in assigning a composite profit percentage within the range of −2 to +2 for these Selected Factors, the Source of Resources factor will always be rated from 0 to −2 percent and the Special Achievement factor will always be rated from 0 to +2 percent. The Other factor may be rated with either a plus or a minus. These factors will rarely be of equal weight in a specific procurement. They should be assigned a weight as a group, in accordance with the following criteria:

(1) *Source of resources (Government or private).* Application of this factor calls for an

analysis of the contractor's dependence on Government financial assistance or material assistance in the form of facilities. Contractor reliance upon Government resources shall be discouraged by providing for less favorable profit consideration. Commercial facilities to be rented by the contractor will be evaluated as contractor furnished. Customary progress payments and guaranteed loans with normal guarantees (90 percent or less) shall not be weighted in this evaluation. However, other forms of financial assistance such as extraordinary progress payments, guaranteed loans with abnormal guarantees, or advanced payments shall be considered a minus factor. Similarly, the reliance on any other type of Government assistance, including facilities shall be evaluated as a minus from zero. The contractor who uses new Government resources for the performance of a contract will be penalized to a greater degree than the contractor who uses existing Government resources.

(2) *Special achievement, if any, required in the contract.* This factor indicates the need for extra profit consideration when outstanding performance is required. Such achievement may be in the form of a special technical requirement, such as production of some remarkable first, or achievements involving non-technical objectives, such as an extraordinarily fast delivery schedule.

(3) *Other.* Particular procurement situations may give rise to the desirability of using a profit factor other than those in subparagraphs (1) and (2) of this paragraph. Such factor shall be identified; and the reason for its use shall be documented in accordance with § 3.811.

[30 F.R. 5982, Apr. 29, 1965, as amended at 30 F.R. 14086, Nov. 9, 1965]

"§ 3.808—6 *Special profit consideration.*

"Contractors who develop military items without Government assistance are entitled to special profit consideration on those items. This consideration shall be in addition to the profit objective arrived at through the weighted guidelines method. One to four percent of recognized cost is established as the normal range of value for this profit factor. The criteria for selection of the specific percentage shall be the importance of the development in furthering defense purposes, the demonstrable initiative in determining the need and application of the development, the extent of the contractor's cost risk, and whether the development cost was recovered directly or indirectly from Government sources."

[30 F.R. 5985, Apr. 29, 1965]